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Takeovers and Incidental Protection of Minority Shareholders

by

Jonathan Mukwiri*

One of the features of takeover law is the protection of minority shareholders. This article examines the extent at which the protection of minority shareholders is an objective of EU law, comparing certain provisions in the Takeover Directive with their equivalent in English law. The arguments advanced in this article are threefold. First, English law offers better protection to minority shareholders than accorded under EU law. Second, that the protection accorded to minority shareholders under EU law is only incidental to the objective of facilitating the restructuring of companies. Third, that in seeking to achieve a restructuring of companies objective, both EU law and English law on takeovers trumps property rights of minority shareholders. The article draws a conclusion that the protection of minority shareholder in takeovers is about market fairness and not legal rights.

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I. Introduction

This article examines the extent to which the Takeover Directive protects the interests of minority shareholders who are affected by a takeover bid. It argues that the protection of minority shareholders during takeovers within the EU legal framework on takeovers is only incidental to achieving economic growth

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in the EU. This economic growth is achieved through the aim of creating an internal market as an area without internal frontiers in which freedom of establishment of companies and free movement of capital is ensured.¹ One way of facilitating these twin freedoms is to facilitate corporate restructuring through regulation of takeovers. To that end, one of the objectives of the Takeover Directive is ‘to prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures.’² At EU level, minority protection is hence a method for achieving corporate restructuring objective.

At EU level, unfair treatment of minority shareholders is therefore a barrier to restructuring of companies. The lack of a level playing field creates this unfairness, which the law must seek to remove. With lack of level playing field, shareholders from different Member States did not have equivalent opportunities to sell their shares, and takeovers could not be launched with the same expectation of success in different Member States.³ To facilitate restructuring of companies, investors must be free to put their money into shares of EU companies in order to establish themselves in another Member State and to provide necessary capital for the development and expansion of those companies.⁴ To this end, the Winter Report proposed that a level playing field must respect the principles of shareholder decision-making and of proportionality between risk-bearing capital and control.⁵ These principles are contained in the Takeover Directive as board neutrality and break-through rules.⁶ This article argues that the Takeover Directive’s protection of minority shareholders is not a protection for their own sake, but is merely incidental to the objective of facilitating EU-wide corporate restructuring.

One of the features of takeover law is the protection of minority shareholders. The extent at which the protection of minority shareholders is an objective of EU law on takeovers is the subject of this article. In this examination, the article compares certain provisions of the Takeover Directive with their equivalent in English law. The arguments advanced in this article are threefold. First, that English law on takeovers offers better protection to minority sharehold-

1 Article 26 of TFEU (ex Article 14 TEC).

2 Recital 3, Directive 2004/25/EC; the Takeover Directive is based on Article 50 of TFEU (ex Article 44 TEC).

3 JL Hansen, ‘When Less Would Be More: The EU Takeover Directive in its Last Apparition’ (2003) 9 *Columbia Journal of European Law* 275, 280.

4 CM Schmitthoff, ‘The Future of the European Company Law Scene’ in CM Schmitthoff (ed) *The Harmonization of European Company Law* (London: UKNCCL, 1973) 7.

5 European Commission, ‘Report of The High Level Group of Company Law Experts on Issues Related to Takeover Bids’ (Brussels 10 January 2002) – herein referred to as the “Winter Report.”

6 Articles 9 and 11 of the Takeover Directive.

ers than accorded under EU law on takeovers. Second, that the protection accorded to minority shareholders under EU law is only incidental to the objective of facilitating the restructuring of companies. Third, that in seeking to achieve the objective of restructuring of companies, both EU law and English law on takeovers trumps property rights of minority shareholders. It is argued that minority shareholder protection in takeovers is about market fairness and not legal rights.

The article proceeds in the following way. First, it examines the cornerstone of takeover regulation in both English law and EU law, discussing rule 21 of the City Code and Article 9 of the Takeover Directive, respectively. Secondly, it discusses the subtle emphasis on corporate restructuring objective as opposed to minority shareholder protection objective, in EU takeover law, looking specifically at the mandatory bid and equal treatment rules. Thirdly, it discusses the extent at which the squeeze-out or/and compulsory acquisition provisions in takeovers or/and in company law trump minority shareholders' property rights and the indifferent law's response of offering to facilitate market fairness as a remedy to such shareholders. Lastly, it makes concluding remarks.

II. Board neutrality and shareholder empowerment

The Takeover Directive governs activities of takeovers in the EU.⁷ The incidental protection of minority shareholders within the legal framework of the Takeover Directive is best understood from an historical perspective. As the Takeover Directive attempted to harmonise rules regarding an activity that predominantly occurs within the UK, the mischief it sought to address is also best understood from the UK historical perspective.

The rules on takeovers in the UK can be traced from the 1960s, and its history is well documented.⁸ In the late 1950s there were mounting concerns about unfair practices in the conduct of takeover offers. These unfair practices were mainly characterised by defensive measures adopted by offeree boards and aimed at frustrating takeover bids. The real losers in these practices were the minority shareholders, as often they were not consulted or given the opportunity to decide on the bids. English company law was unhelpful to the aggrieved minority shareholders in challenging company directors who frustrated the bids, as directors owe their duties to the company and not to shareholders.⁹ As long as, or at least purportedly, the directors acted in the

7 The Takeover Directive 2004/25/EC [2004] OJ L142/12.

8 See R Falkner, 'Judicial review of the takeover Panel and self-regulatory organisations' (1987) 2 *Journal of International Banking Law* 103, 104–105.

9 *Percival v Wright* [1902] 2 Ch 421

interest of the company as a whole,¹⁰ they were entitled to resist any attempts of a takeover.

It is against these unfair practices that minority protection was devised via the rules on takeovers. By 1959, a solution to these unfair practices was found through the requirements of the 'Notes on Amalgamation of British Businesses,' a measure introduced by the Issuing Houses Association. The rules in these 'Notes' were revised in 1963 to cater for equal treatment in requiring the offeror to make equivalent offers to other classes of shareholders whose shares had not been purchased after a certain controlling stake had been obtained. As these measures under the 'Notes' were still inadequate to protect shareholders, the Takeover Panel was set up in March 1968, and a City Code on takeovers was drawn up in 1985. One of the key aims of UK takeover regulation is the protection of minority shareholders.¹¹ This is achieved through the purpose of the City Code, which is to 'ensure that shareholders in an offeree company are treated fairly and are not denied an opportunity to decide on the merits of a takeover.'¹² The central feature of the City Code is the board neutrality rule, which empowers shareholders to take decisions on takeover offers.

A brief history of rule on takeovers at EU level indicates that the Takeover Directive began life as a model of the UK regulatory system. In 1974, Professor Robert Pennington,¹³ having been appointed by the Commission to write a report on takeovers in Europe, produced a report on Takeover Offers,¹⁴ with a draft takeover directive attached, which had been modelled on the UK's City Code, with a heavy UK influence. It then took thirty years of negotiations, characterised by drawbacks, frustration, opposition and compromises, to adopt the Takeover Directive. The controversial provisions were the mandatory bid and the board neutrality rules, which were mainly influenced by the UK and were designed to break down the laws of Germany, the Netherlands, and other continental European countries that were hostile to takeovers.¹⁵ The

10 The phrase "company as a whole" is controversially attributed to shareholders or the commercial entity.

11 J Payne, 'Minority shareholder protection in takeovers: A UK perspective' (2011) ECFR 145, 155.

12 The City Code on Takeovers and Mergers (10th edition, 2011) A1 paragraph 2 (a).

13 Professor Sir Robert Pennington (1927–2008) was a renowned English company law expert – see J Gill, 'Obituary: Robert R Pennington' (2008) *The Times Higher Education*, 27 March.

14 European Commission, 'Report on Takeover Offers and Other Offers', Document XI/56/74; see also KJ Hopt, 'Takeover regulation in Europe – The battle of the 13th directive on takeovers' (2002) 15 *Aust JCL* 1, 8.

15 KJ Hopt, 'Takeover regulation in Europe – The battle for the 13th directive on takeovers' (2002) 15 *Aust JCL* 1, 9; see also Heribert Hirte, *Commentary on the German*

final version of the Takeover Directive, modelled on the City Code, was adopted in 2004, to take the English style of minority protection across the EU.

Taking an English style of minority protection in takeovers across the EU via the Takeover Directive was not without controversy. The controversy, and indeed the problem, were due to and still lies in the Takeover Directive's aim of introducing into Member States the corporate culture of other Member States.¹⁶ For example, whilst the UK was used to the idea of a mandatory bid, Germany was not,¹⁷ yet the Takeover Directive took the course of introducing a mandatory bid provision. The German reluctance to accept the mandatory bid rule was based on the argument that the Takeover Directive does not per se favour minority shareholders as does the German law of groups of companies (Konzernrecht). As a general distinction, the mandatory bid protects shareholders prior to the takeover (ex ante), as an exit strategy, whereas the German Konzernrecht, which also deals with fiduciary duties, protects minority shareholders after the bid has been successful (ex post) – neither of the two models works perfectly, and thus, effective minority shareholder protection would require both forms of protection; which is the very result of the German setting in which the Konzernrecht is not preempted by EU takeover law.¹⁸ The Takeover Directive aims at 'making takeover safeguards equivalent throughout the Community';¹⁹ and 'protecting the interests of holders of the securities of companies governed by the law of Member States'.²⁰ To this end, the Takeover Directive seeks 'to prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures'.²¹ Whereas achieving this lies in the Takeover Directive's two key provisions of the board neutrality rule and breakthrough rule,²² these provisions are optional to Member States under Article 12.

Securities Acquisition and Takeover Act (WpÜG), 2010, Introduction, marginal no. 66 and – with criticism towards the final version of the Directive sec.33 marginal no. 12 et seq. (with regard to the board neutrality rule).

16 M O'Neill, 'When European integration meets corporate harmonisation' (2000) 21 Co Law 173, 175.

17 JA Faylor, 'Germany: A legal guide' (1998) IFLR 34, 35 – notes that Germany was opposed to the inclusion of a mandatory bid provision (now Article 5 of the Takeover Directive), on grounds that their Stock Corporation Act [Aktiengesetz] was sufficient to protect shareholders otherwise for which a mandatory bid was sought.

18 See Heribert Hirte, Commentary on the German Securities Acquisition and Takeover Act (WpÜG), 2010, Introduction, marginal no. 79 a.

19 Recital number 1 of the Takeover Directive.

20 Recital number 2 of the Takeover Directive.

21 Recital number 3 of the Takeover Directive.

22 Articles 9 and 11 of the takeover Directive, respectively.

Rule 21 of the UK's City Code prohibits company directors from taking any action that would frustrate a takeover bid, in the event of an offer or imminent offer, without prior authorisation of shareholders. This is enshrined in Article 9 of the Takeover Directive, which facilitates transparency by vesting the power of decision-making in the shareholders. As directors are traditionally answerable to the company and not to shareholders, their decisions during a takeover bid could be questionable as to whether they are in the interest of shareholders. As such, ensuring protection of the interests of shareholders, Article 9 precludes directors from taking any action, or decision which would otherwise frustrate a bid.

Company law generally gives power of decision-making to shareholders by means of a vote in the general meeting. Takeover regulation takes the same approach when it requires that directors should seek shareholders' approval in a general meeting before adopting measures or actions that may frustrate a takeover bid. The need to defer decision-making on the merits of a takeover bid to shareholders was also supported by the Winter Report.²³ In tightening the empowering of shareholders, the Winter Report recommended that boards should not use shareholders' decisions taken prior to a bid to frustrate a bid. Only when a bid is actually announced, and the shareholders can really assess relevant information, can they in fairness be asked to decide whether this takeover bid should be frustrated by the board or not.²⁴ The Winter Report suggested that the board should not take steps to favour a bid that in any way pre-empts the right of shareholders to reject it – in other words, shareholders must have the final word on the outcome of a takeover bid.²⁵ The Takeover Directive adopts the spirit of the Winter Report on the question of pre-bid versus post-bid decisions. This paternalistic approach to shareholder protection would give greater protection to minority shareholders.

In requiring boards to use shareholders' post-bid decisions, the Winter Report seems to have taken the view that shareholders can only fairly decide on the merits of a takeover bid once they are actually faced with one. On the reasoning that this assumes that shareholders are too confused or disinterested to calculate the risk of their pre-bid decision, it has been questioned why then assume that shareholders are sufficiently competent to make decisions on defensive tactics in the post-bid period, and hence the assumption criticised as too sweeping.²⁶ Another view is to treat this as a paternalistic approach

23 A report by Jaap Winter, that is: European Commission, 'Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe' (Brussels, 4 November 2002).

24 Winter Report, 2002, Recommendation 1.2.

25 Winter Report, 2002, 27.

26 Allen Ferrell, 'Why Continental European Takeover Law Matters' In: Ferrarini and

designed to protect minority shareholders who may lack full information during the pre-bid period. The approach would empower minority shareholders to participate in post-bid period, whilst protecting the majority from giving the board a blank cheque. Although the majority shareholders should be free to make decisions that are potentially detrimental to them, even if *ex post* shareholders would not find it in their interest for the board to interfere with the acceptance of the bid,²⁷ shareholders' defensive decision taken in the pre-bid period would weaken market confidence and in effect amount to an early defeat of the main objective of corporate restructuring at EU level.

Thus, a strict application of Article 9, equivalent to the long-standing provision of the UK's City Code,²⁸ facilitates corporate restructuring at EU level, and creates market confidence whilst empowering minority shareholders. At UK level, this central feature of the City Code has always had the effect of limiting defensive tactics such that management would not appeal to shareholder loyalty or patriotism or use their own resources to buy target company shares in the market.²⁹ As residual beneficiaries of the company assets, combined with the common law requirement that decisions be taken for a proper purpose,³⁰ it is sensible to vest decision-making ultimately with the shareholders. At EU level, the cornerstone of shareholder protection is Article 9, which prohibits boards from taking decisions that would frustrate the bid, and empowers shareholders to make the decisions on the bids. While uncontroversial to British eyes accustomed to the City Code, Article 9 would have had the effect of changing the centre of gravity of more managerialist and stakeholder-orientated systems of corporate governance, but for the compromises that reduced it to an optional provision.³¹ Instead of making mandatory the board neutrality rule, a long-standing central feature of UK takeover rules, to better protect shareholders across the EU, the Takeover Directive waters it down by making it optional. Thus, the UK rules offer a better protection to minority shareholders than the EU law on takeovers.

From a British perspective, we could conclude that subjecting Article 9 of the Takeover Directive to optional arrangements fails to remove the unfair prac-

others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 561, 573.

27 P O Mulbert, 'Make it or break it: the break-through rule as a break-through for the European takeover Directive?' in G Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 711, 724–725.

28 Rule 21(1) of the City Code.

29 PL Davies, 'The Regulation of Defensive Tactics in the United Kingdom and the United States' in Hopt and Wymeers, *European Takeovers* (Butterworths, London 1992) 200.

30 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

31 A Johnston, 'The European Takeover Directive: Ruined by protectionism or respecting diversity' (2004) 25 Co Law 270.

tices and therefore the Takeover Directive fails to protect shareholders. Eilis Ferran has therefore commented that ‘the Takeover Directive in its final form is an embarrassment for the EU: so much time and effort spent to achieve so little.’³² By making its core optional, the Takeover Directive was doomed *ab initio* to fail in both the method (the protection of shareholders) of achieving and its intended objective (the restructuring of companies). With Article 9 left optional, such ‘optionality device ends up setting forth (or, better, tolerating) a Babel-like system for takeover defences around the various national legislations.’³³ But with need to compromise, making certain provisions optional was ‘the only practical way to ensure that the rules in question, which might be capable of benefiting a large number of firms, become law.’³⁴

But the compromised Takeover Directive is still workable. Firstly, at EU level, it is here argued, protection of minority shareholders is only incidental to achieving the objective of facilitating corporate restructuring. As to the objective of restructuring of companies, an opt-out does not entail derogation from the fundamental freedom of establishment.³⁵ Secondly, the optional arrangement of Article 9 is mitigated by the general principle of Article 3(1)(c), which requires that the offeree board must act in ‘the interest of the company as a whole’ and must not deny the shareholders the opportunity to decide on the bid.³⁶ This means that, in the case of a national or corporate opt-out, the board of the company should obstruct only inadequate offers and should not frustrate adequate bids or deprive shareholders the opportunity to decide on the merits of adequate bids.³⁷ Thus, it is here argued, the Takeover Directive, whilst primarily pursuing the objective of freedom of establishment of companies and free movement of capital, it is nonetheless capable of, albeit incidentally, protecting minority shareholders.

32 E Ferran, *Building an EU Securities Market* (Cambridge, Cambridge University Press, 2004) 117.

33 M Gatti, ‘Optionality Arrangements and Reciprocity in the European Takeover Directive’ (2005) 6 EBOR 553, 567.

34 JA McCahery and EPM Vermeulen, ‘The case against reform of the Takeover Bids Directive’ (2011) 22 EBL Rev 541, 550.

35 DA Wyatt, ‘Horizontal Effect of Fundamental Freedoms and the Rights to Equality after *Viking* and *Mangold*, and the Implications for Community Competence’ (2008) 4 Croatian Yearbook of European Law and Policy 1, 47.

36 The phrase ‘interests of the company as whole’ in the context of the Takeover Directive is not a reference to ‘shareholders’ but to the company as an enterprise – see B Sjafjell, ‘The Core of Corporate Governance: Implications of the Takeover Directive for Corporate Governance in Europe’ (2011) 22 EBL Rev 641, 645–652; concerning this provision, see also Heribert Hirte, *Commentary on the German Securities Acquisition and Takeover Act* (WpÜG), 2010, sec. 33 marginal no. 13.

37 Thomas Papadopoulos, *EU Law and the Harmonization of Takeovers in the Internal Market* (Kluwer Law International, 2010) 210.

However, certain provisions primarily aimed at restructuring of companies are not capable of furthering the protection of minority shareholders. One of these provisions is the Takeover Directive's break-through rule under Article 11, based on the principle of proportionality between risk-bearing capital and control. By this rule, if following a bid, the offeror holds 75 per cent or more of the capital carrying voting rights, no restrictions on the transfer of shares or on voting rights nor any extraordinary rights of shareholders concerning the appointment or removal of board members provided for in the articles of association of the offeree company shall apply. The principle behind Article 11 is the realisation that, if restructuring of companies and capital markets are to be facilitated, entrenched company rights must give way. The principle is not novel in English company law, but seems too radical and hardly a minority protection provision to the extent that it expropriates rights secured by shareholders. In comparison, the German Federal Constitutional Court allows an expropriation of shareholders' rights only in return for fair compensation.³⁸

English company law in general has always sought to achieve a balance between the rights secured by shareholders as a reflection of their bargains, and the economical need to remove barriers that stifle the expansion of company business. Company law provides a mechanism for altering the articles.³⁹ The alteration must be for the benefit of shareholders.⁴⁰ Where the rights are class rights, including multiple-voting rights attached to particular shares, company law provides a particular mechanism for altering such rights.⁴¹ Minority shareholders who have certain rights entrenched in the articles of association, such as the right to appoint a director, are particularly protected in company law.⁴² Where the rights cannot be altered by other mechanisms, company law provides a compromise arrangement that involves the holders of the rights and the courts.⁴³ What the Takeover Directive requires in Article 11 is a radical approach that cuts through and ignores minority protection provisions in English company law. However, Article 11 is

38 See the judgment BVerfGE 27. 4. 1999 – 1 BvR 1613/94, E 100, 289 and the preceding judgment 7. 8. 1962 – 1 BvL 16/60, E 14, 263.

39 Section 21 Companies Act 2006 – at least 75 per cent of the shareholders must agree to the alteration.

40 *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656; *Greenhalgh v Ardenne Cinemas Ltd* [1950] 2 All ER 1120.

41 Section 630 Companies Act 2006 – requires consent of at least 75 per cent of the affected shareholders.

42 *Cumbrian Newspapers Ltd v Cumberland & Westmoreland Printing Ltd* [1987] Ch 1 – a minority shareholder holding only 10 per cent of the shares successfully claimed class right to appoint a director.

43 Section 895 Companies Act 2006 – requires meetings with the holders of the rights, and approval by the courts of the compromise reached with holders of those rights.

optional for Member States,⁴⁴ and the UK opted out of it.⁴⁵ But for being optional, Article 11 furthers a corporate restructuring objective.

III. Mandatory bid principle and shareholder protection

In protecting minority shareholders from unfair practices during a takeover bid, takeover law provides for a mandatory bid to foster a level playing field of share deals. This though largely furthers the corporate restructuring objective for financially sound bidder. But besides a corporate restructuring objective, there is arguably a share value to be gained by the minority shareholders in tendering their shares once a mandatory bid is triggered. It is said that in continental European market, private benefits of control are higher for the selling controller than for acquiring controller. This is because in family controlled companies, ‘reputation benefits ... are of primary importance ... are hardest to transfer to another owner, because they take time to build, are owner-specific, and in many cases require family or at least geographical membership.’⁴⁶ As such, in private family controlled companies, minority shareholders would be better off tendering their shares to the new controller to avoid post-bid decreasing share value.

The mandatory bid rule originated in the UK in 1968, and as takeover activity increased in Continental Europe during the 1980s, other countries began to adopt mandatory bid rules, modelling theirs after the UK’s.⁴⁷ The mandatory bid principle is aimed at protecting the minority shareholder in share deals. The Takeover Directive requires that once the offeror has gained a certain threshold of control of the offeree company, the offeror must make a mandatory bid ‘as a means of protecting the minority shareholders of that company.’⁴⁸ In the UK, this is implemented by section 943 of the Companies Act 2006, which essentially gives effect to the relevant rules of the City Code.⁴⁹ The threshold triggering a mandatory bid in the UK is 30 per cent.⁵⁰ The aims

44 Article 12 of the Directive makes Article 11 (and Article 9) optional.

45 Sections 966–972 Companies Act 2006 – but allows companies to opt in to Article 11 should they wish to.

46 O Ehrhardt and E Nowark, ‘Private Benefits and Minority Shareholder Expropriation – Empirical Evidence from IPOs of German Family-Owned Firms’ (March 22, 2002, CFS Working Paper No. 2001/10).

47 J Grant, T Kirchmaier and JA Kirshner, ‘Financial tunnelling and the mandatory bid rule’ (2009) EBOR 233, 235–236.

48 Article 5 Takeover Directive.

49 Rule 9 of the City Code.

50 Rule 9 of the City Code provides two situations: (a) acquiring shares which carry 30% or more of the voting rights, and (b) a holder of between 30% and 50% who acquires additional shares increasing voting rights.

of the mandatory bid rule are twofold: preventing arbitrary control on acquisition and preventing unfair treatment of shareholders during acquisition.

On one hand, the mandatory bid rule aims at preventing clusters of share purchases that would transfer control in the target company thereby locking in shareholders without being offered an opportunity to decide on such control. In this regard, the rationale behind the mandatory bid is often said to be the protection of minority shareholder from potential adverse activities of the new controlling shareholder. To that argument, the minority would be willing to sell his shares at the price offered, in order to exit the company. This, it is said, is due to the minority shareholders' finding themselves in a company, where the danger of exploitation of resources for private interest is graver, and corporate policy is going to be unilaterally determined by the new controlling shareholder.⁵¹ It is argued that, rather than policing the behaviour of the new controlling shareholder, the mandatory bid provides a remedy for the minority shareholders by allowing them to exit the company in advance.⁵²

As an exit remedy for minority shareholders, the mandatory bid may eliminate opportunistic acquirers, as it forces the offeror to pay a premium to gain control. The rule may prevent 'looters' who are interested in short-term investment whilst enabling long-term investors who are willing to pay an exit price to minority shareholders to acquire control. But whilst the rule may have a preventive effect as regards to out right 'looters,' if the potential gain from looting is regarded as large enough, the takeover may be carried out anyway.⁵³ Regardless of whether the new controller is a looter or honest long-term investor, the rule seeks to provide a fair exit price to the minority shareholder. The rule is here concerned with market fairness.

On the other hand, the mandatory bid rule aims at preventing the offering of different levels of share prices without extending the same price to all shareholders. In this regard, the rule protects the minority shareholders by ensuring that they receive the control premium. As the offeror holding more than 30 per cent is required to bid for all the shares, acquiring shares becomes expensive and only a financially sound bidder pursues the bid. The rule requires an equitable price to be extended to all remaining shareholders, which is determined by reference to the highest price paid in the previous 12 months.⁵⁴ This price takes into account the price paid for private purchases so that the minor-

51 G Psaroudakis, "The Mandatory Bid and Company Law in Europe" (2010) *ECFR* 550, 552.

52 G Psaroudakis, "The Mandatory Bid and Company Law in Europe" (2010) *ECFR* 550, 554.

53 B Sjafjell, 'The Core of Corporate Governance: Implications of the Takeover Directive for Corporate Governance in Europe' (2011) 22 *EBL Rev* 641, 697.

54 Article 5 of the Takeover Directive.

ity is able to benefit from the premium even where the minority had been bypassed via a private transaction within the period.

The criterion for determining an equitable price is one of the legacy recommendations of the Winter Report. In recommending this criterion, the Winter Report sought to enable efficient functioning of capital markets in the EU by providing a sufficient degree of predictability as to the consideration to be offered in a mandatory bid.⁵⁵ By means of this criterion, an offeror is able to predict how much he will pay for the shares, and the shareholders are able to predict how much to expect. Thus, on one hand the rule prevents arbitrary control in the company against interests of other investors, and on the other hand it prevents unfair treatment of shareholders.

However, the very rule is capable of escalating arbitrary control, as uncertainty increases when shareholders are lured by the offer and many shareholders give in rendering the others minority and making shareholding for such minority less attractive. Take for example under the UK's threshold of 30 per cent, an investor who may only want to raise his portfolio to say 35 per cent, leaving other shareholders in investment, is forced by the rule to bid for all remaining shares, causing a panic of sale by other shareholders who otherwise would have lived with a 35 per cent majority shareholder. In distinguishing takeover law from the German Konzernrecht, the Konzernrecht addresses the problem of control by defining control from a more material approach and not as a percentage of shareholding as does takeover law. In a takeover situation, it is, however, difficult to see a better way than by a mandatory rule. If it is left to the market forces of demand and supply, minority shareholders may not even have the remedy of selling their shares at a fair price. But a point not to be ignored is the effect of acceleration of arbitrary control in the company causing a squeeze out of the minority who may not have the means to invest elsewhere, thereby destabilising minority investment portfolios.

The mandatory rule also has the potential of limiting investment growth to 29.9 percent, as beyond that point, an investor must make a mandatory bid to all the shares. Thus, small stake investors cannot invest beyond 29.9 per cent unless they are financially sound to pay all the shares in a company. Other than a condition of obtaining 50 per cent or more acceptances, rule 13 of the Code limits an investor's ability to attach conditions to the offer. Thus, if an investor cannot comply with all the requirements, his option only lies in maintaining a low share portfolio capped at 29.9 per cent and to sell his shares to a majority and wealthier bidder.

A flexible application of the mandatory bid rule would protect the dual interests of the offeror and offeree. As the mandatory bid rule originated from the

55 Winter Report (2002) 49.

UK, lessons could be learnt from the Takeover Panel's historical approach. Under the so-called self-regulation, the Takeover Panel applied the mandatory bid rule in a flexible manner. For example, on 29 October 1987, less than two weeks after the stock market crash, the Bank of England offered a rescue plan to underwriters who had agreed to buy shares of British Petroleum (BP), by which the Bank of England offered to repurchase any and all partly-paid BP shares from the underwriters.⁵⁶ This plan had the effect of putting the shareholding of the Bank of England to 36 per cent, which in accordance with the City Code would have required the Bank of England to make a mandatory offer to all investors. Applying a flexibility approach, the Takeover Panel agreed that, if the bank of England were to purchase the shares and thereby reach a 36 per cent stake, it would not be required to make a mandatory offer, provided the Bank of England agreed to vote only 29.9 per cent of its shareholding.⁵⁷ This flexibility served the dual interests of the offeror's acquisition of shares and offeree's protection from arbitrary control.

But because the protection of minority shareholders at EU level is only incidental to the objective of facilitating corporate restructuring, and not a protection for its own sake, this flexibility is best confined to national level. Even at national level, in implementing the Takeover Directive, this kind of flexibility has to give way to wider EU interest. Indeed, the UK's Takeover Panel lost this flexibility when it transformed from self-regulator to statutory regulator. This so-called flexibility is capable of rendering takeover rules uncertain. To avert this uncertainty, whilst the Takeover Panel may change the rules in the City Code, section 944 of the Companies Act 2006 now requires that the Panel publishes such changes first. As such, the flexibility that would allow the Takeover Panel to suddenly change the rules, thereby causing uncertainty, has been limited.

Parties who cannot or do not wish to pay the highest price paid in the previous 12 months,⁵⁸ would have to stagger their acquisition beyond 12 months. For example, in *Gilgate Holdings Ltd*,⁵⁹ a number of parties bought shares in a manner that was against the spirit of the rule, and yet they were not found to be in breach of the rule. These parties bought 29 per cent of the shares at 22.5 pence per share, and after 12 months plus one day they bought more shares equivalent to 7 per cent at only 8.75 pence per share. Enforcing

56 See Chris Muscarella and Michael Vetsuypeus, 'The British Petroleum Stock Offering: An Application of Option Pricing' (1989) 1 *Journal of Applied Corporate Finance* 74, 77–80.

57 T Tridimas, 'Self-regulation and investor protection' (1991) 10 *Civil Justice Quarterly* 24, 30.

58 Article 5 of the Takeover Directive.

59 Reported in Takeover Panel Statement on 14th March 1980.

the mandatory bid required the concerted parties to offer to pay only 8.75 pence per share, being the highest price they had paid for shares in the last 12 months. This loophole is not covered by the City Code in its present form and is not covered by the Takeover Directive as implemented by the Companies Act 2006.

IV. Equal treatment of shareholders and information disclosure

Takeover rules, especially on equal treatment and information disclosure, offer better protection to minority shareholders, albeit a protection based on market fairness as opposed to strict legal rights, than accorded under mainstream company law. This can be appreciated by briefly examining the position of minority shareholders in English law. From the common law perspective, minority shareholders have always had very little protection. First, the power to manage the business of the company is given to either the majority shareholders in the general meeting or the board of directors via the articles of association;⁶⁰ but this power is traditionally reserved for the board of directors.⁶¹ There is less minority protection here.

Secondly, the directors who manage the company are not answerable to the shareholders but to the company itself.⁶² The traditional statutory power of the shareholders to manage the business of the company is to appoint and remove directors from office;⁶³ even then, the practical dimension of this limited power lies with the majority shareholders in the general meeting, which leaves the minority less protected.

In the landmark case of *Foss v Harbottle*,⁶⁴ common law showed that minority shareholders were less protected from mainstream company law perspective. Two points emerged in this case. First, where there is an alleged wrong on the company, the proper claimant is the company itself and not the aggrieved shareholder. Secondly, if the majority approved of the act of the directors, the minority shareholder could not be heard in court. Gradually, this common law lack of adequate protection of minority shareholders changed. The courts

60 *Automatic Self-Cleaning Filter Syndicate Co Ltd v Cuninghame* [1902] 2 Ch 34.

61 *Harold Holdsworth & Co (Wakefield) Ltd v Caddies* [1955] 1 WLR 352; Under the former Table A Regulations Article 70 (1985), the business of the company was managed by the directors who exercised all the powers of the company – this still apply by default under section 20 of the Companies Act 2006.

62 *Percival v Wright* [1902] 2 Ch 421 – Directors do not, in general, owe any contractual or fiduciary duty to shareholders.

63 Section 168 of the Companies Act 2006 – requires a majority vote by ordinary resolution.

64 (1843) 2 Hare 461.

have acknowledged the lack of protection given to minority shareholders. Indeed, in the words of Hoffmann:

... the emancipation of minority shareholders is a recent event in company law. For most of the twentieth century minority shareholders were virtually defenceless, kept in cowed submission by a fire-breathing and possibly multiple-headed dragon called *Foss v Harbottle*. Only in exceptional cases could they claim protection of the court. ... A statutory remedy was provided for the first time in 1948 but this proved relatively ineffectual. It was not until 1980 that Parliament forged the sword ... section 459 of the CA 1985 [now section 994 CA 2006] and which enables the unfairly treated minority shareholder to slay the dragon.⁶⁵

Whereas the statute offered some protection to minority shareholders, by virtue of section 994 of the Companies Act 2006, this has not been without its shortfalls. The principles of common law have time and again led the interpretation of section 994 to the extent that the majority of minority shareholders are looked upon to decide the fate of a minority within a minority.⁶⁶ It is perhaps due to the weakness of the common law that shareholder protection became the iconic theme of the self-regulated takeover industry since 1968, under the Takeover Panel, a body that governs takeovers in the UK, with the emergence of the City Code on Takeovers. Aggrieved minority shareholders with less protection under mainstream company law can now find an exit remedy in the City Code where the company becomes a target of a takeover. The introduction of the Takeover Directive reaffirms the rules in the City Code as to the principle of equality of treatment of all shareholders during takeovers.

In the UK, the rules on equal treatment of all shareholders during a takeover period are contained in the City Code. The underlying objective of these rules is to prevent the transfer of effective control through selective acquisitions at inflated prices without offering the same terms to all shareholders.⁶⁷ As regards the principle of equal treatment of all shareholders during a takeover period, the Takeover Directive introduced nothing novel but was modelled after the rules in the City Code. The guiding principle underpinning the equal treatment rule is that company law should be primarily enabling or facilitative – which does not eliminate legal intervention – which includes the avoidance of substantial market failure by providing mandatory provisions to protect

65 Robin Hollington, *Minority Shareholder's Rights* (Sweet & Maxwell, London 1999) Foreword [a Foreword' by Lord Hoffmann].

66 In *Smith v Croft (No. 2)* [1987] 3 All ER 909, 942 (Knox J), the idea of paying regard to the views of an independent majority of shareholders within a minority shareholders who petition the courts in a derivative action was developed.

67 T Tridimas, 'Self-regulation and investor protection in the UK: the takeover panel and the market for corporate control' (1991) 10 CJQ 24, 32.

shareholders.⁶⁸ This is reflected in the Companies Act 2006,⁶⁹ enabling the Takeover Panel to make rules, includes rules on equal treatment of shareholders, as contained in the City Code.

In the UK, under the City Code, the principle of equal treatment for all shareholders has two limbs: equivalent offer value extended to all shareholders, and same information to be given to all shareholders. The rules on equivalent offer value are detailed and extensive enough to offer equal treatment to all shareholders. The rules in the City Code on equivalent offer value include: same terms of offer to all holders of the same class of shares; same terms of revised offer; if acquired by cash then extend cash offer to all; if shares are acquired by exchange of shares then the bidder must extend exchange of share offer to all; comparable offers to all; appropriate offer to all; no special deals for some; and all entitled to revised offer.⁷⁰

As to providing same information to all shareholders, the rules are equally comprehensive in order to accord equal treatment. The rules in the City Code on disclosure of information include: accurate information; board to take responsibility for information; timely information; to requiring of the giving of same information to competing offerors; requiring sufficient information dissemination by the boards; detailed financial information; and up to date information.⁷¹

The rationale of the City Code is the equality of access to the market as between institutional investors and their private counterparts, the protection of the minority, and the prevention of the pressure to tender.⁷² To the extent of its comprehensiveness in regard to the rules, and in terms of achieving equal treatment of shareholders, the City Code surpasses most regulatory rules elsewhere, including regulations in the USA.⁷³ But this equal treatment is confined to takeovers, as English company law does not impose a duty on directors to treat shareholders equally, but to have regard to the need to act fairly as between members of the company.⁷⁴ A similar duty to act fairly as between members, akin to English fiduciary duties, is seen in the German Konzernrecht. Given that most German companies are members of Konzerne,

68 Modern Company Law for a Competitive Economy – Final Report (DTI, London July 2001) 5.

69 Section 943 of the Companies Act 2006.

70 See City Code rules 6.1, 6.2, 11.1, 11.2, 14, 15, 16, and 32.3, respectively.

71 See City Code rules 19.1, 19.2, 20.1, 20.2, 23, 24 & 25, and 27.1.

72 Panel answers to DTI inquiry of July 1974, cited in MA Weinberg and MV Blank on *Takeovers and Mergers* (4th edn Sweet & Maxwell, London 1979) 569.

73 See DA DeMott, 'Current issues in tender offer regulation: lessons from the British' (1983) 58 NYUL Rev 945, 983–987.

74 Section 172 of the Companies Act 2006.

the Konzernrecht arguably offers broader minority protection to such companies – which is why the Konzernrecht is applied independently from takeover law. In takeovers, the equal treatment rule is designed to protect minority shareholders against unfair market practices.

At EU level, it was argued that the concept of equal treatment has no legal justification, that the concept cannot be viewed as an application of the general principle that companies have a duty of equal treatment of shareholders, because it involves horizontal relationship between the shareholders and European company laws have no principle imposing equal treatment horizontally.⁷⁵ This raises the question whether takeovers should be discussed as a matter of securities law (with its emphasis on ‘soft-law’) or company law (with its emphasis on ‘strict-law’). Whereas takeover bids would be considered to belong to securities law in most Member States, the EU deals with it from the apparent angle of company law.⁷⁶ But the fact that, unlike the draft directive that was titled as the ‘thirteenth company law directive,’ the final version of the takeover directive was not title as such, raise doubts as to the nature of the Takeover Directive being of company law as opposed to securities law.⁷⁷ As to equal treatment of shareholders, the seemingly lack of legal justification is covered by how the Takeover Directive is implemented and interpreted. To bring equal treatment in line with the rigours of the ‘strict-law’ nature of company law, the Takeover Directive requires an EU Treaty interpretation. Equal treatment then becomes a method of facilitating the restructuring of companies to create an internal market that ensures freedom of establishment of companies and free movement of capital.⁷⁸ At EU level, this is arguably an example of how takeover rules have the effect of altering the understanding of mainstream company laws.

Discussing takeovers from securities law perspective, there is a market argument that it is wasteful to legislate on takeover activities if only to achieve equal treatment of shareholders. The authors of this theory argued that shareholders need not be treated equally in particular takeover transaction, because, by diversifying their investment portfolios, investors may protect against the

75 Enriques, ‘The Mandatory Bid Rule in the Proposed EC Takeover Directive: Harmonization as Rent-Seeking?’ In Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 767, 790.

76 Eddy Wymeersch, ‘About techniques of regulating companies in the EU’ in Guido Ferrarini (ed) *Reforming company and takeover law in Europe* (OUP, Oxford 2004) 150.

77 See Hirte and Heinrich, *Commentary on the German Securities Acquisition and Takeover Act* (WpÜG), 2010, Introduction, marginal no. 79 et seq.; with regard to conflict-of-laws questions Josenhans, ZBB 2006, 269, 279; with regard to this question in general, see also Berding, WM 2002, 1149 et seq.

78 Article 26 TFEU (ex Article 14 TEC).

risk of consistently falling on the losing side of unequal treatment.⁷⁹ The authors argued that if the market can even out apparent inequality in this way, the costs of unneeded rules to promote equality might well be thought socially wasteful.⁸⁰

In response to this market argument, it is argued that the total portfolios of most individual investors are so small that they are unlikely to achieve adequate diversification through direct investment in shares and that adequate diversification is difficult to achieve in the light of the difficulty of determining in advance what investments might be subject to some degree of unequal treatment in an acquisition transaction.⁸¹ Thus, a legal company law style response via the Takeover Directive affirming the long-standing principle of the City Code should be seen as the most appropriate protection of minority shareholders' interests. One of the aims of the equal treatment principle is to remove the risk of minority suffering the use of 'front-end loaded' tactics.⁸² Thus, at EU level, this incidentally protects minority shareholders whilst facilitating corporate restructuring. This protection is only incidental and confined to takeovers because equal treatment of shareholders is not a general principle of EU law.⁸³

V. Squeeze-out and sell-out rights of shareholders

The squeeze-out right is the right of the majority shareholder to compulsorily purchase the shares of the minority shareholder.⁸⁴ For a minority shareholder, what is at stake here is the property rights represented by the shares he maybe unwilling to sell. In English law, 'shares in a company are personal property.'⁸⁵ A share, as a personal property, is 'the interest of the shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se in accordance with s 16

79 Easterbrook and Fischel, 'Corporate control transactions' (1982) 91 Yale LJ 698, 712–714.

80 Easterbrook and Fischel, 'Corporate control transactions' (1982) 91 Yale LJ 698, 708–711.

81 DeMott, 'Current issues in tender offer regulation: lessons from the British' (1983) 58 NYUL Rev 945, 983.

82 Guido Ferrarini (ed) *Reforming company and takeover law in Europe* (OUP, Oxford 2004) 753.

83 See Case C-101/08 *Audiolux SA and others v Groupe Bruxelles Lambert SA (GBL) and others* [2009] ECR I-9823.

84 Article 15 of the Takeover Directive.

85 Section 541 of the Companies Act 2006.

of the Companies Act 1862 [s 33 Companies Act 2006].⁸⁶ The problem is that the squeeze-out right is imposed on the minority shareholder not by the 'mutual covenants' contained in the articles of association but rather by law external of the bargains the shareholder made when he acquired the shares.

A further problem the minority shareholder faces is even where his right to keep his shares are provided by the articles of association, this right can be altered by a majority vote, which alteration will be binding on him even when he protests. On the other hand, commercial practice in takeovers is to treat minority shareholders who refuse to sell when offered a fair price as free riders. In anticipating an increased post-takeover share value, shareholders may hold out during the bid, and hope to sell at a later stage, creating the free rider problem. The law's response, favouring the majority, is to clear the market of free riders, furthering the corporate restructuring objective, by facilitating the bidder in squeezing-out the minority shareholder. The squeeze-out allows the bidder to overcome the free rider problem.⁸⁷ These rights have long existed under UK company laws, and the implementation of the Takeover Directive simply restates with minor changes the old provisions.⁸⁸

The historical position in English law was such that a company that made an offer for another company's shares had no power to compel any shareholder to part with his holding against his will.⁸⁹ This common law position changed with the enactment of the Companies Act 1928.⁹⁰ Subsequently over the years the right of squeeze-out, together with the right of sell-out, were fully cemented in English company law.⁹¹ A restatement of these rights, taking into account the recommendations of the Company Law Review,⁹² and for the purpose of implementing the Takeover Directive, is contained in the Companies Act 2006.⁹³

86 *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279 at 288 *per* Farewell J.

87 M Burkart and F Panunzi, 'Mandatory bids, squeeze-out and the dynamics of the tender offer process' in G Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 737, 793.

88 Sections 974 to 991 of the Companies Act 2006 restate provisions in Part 13A of the Companies Act 1985, incorporating recommendations of the Company Law Review 2001, and in line with the Takeover Directive.

89 See *Re Castner-Kellner Alkali Co Ltd* [1930] 2 Ch 349; and *Re Hoare & Co Ltd* [1933] All ER Rep 105.

90 Section 50 of the Companies Act 1928; later section 209 of the Companies Act 1948 – imposed an equivalent of a squeeze-out right to compel a remaining minority shareholder to sell his shares to a successful bidder.

91 Part 13A of the Companies Act 1985.

92 See *Modern Company Law for a Competitive Economy – Final Report* (DTI, London July 2001) 292.

93 Sections 974 and 991 of the Companies Act 2006.

It is here that protection of minority shareholders at both EU and UK levels seem to take an approach that seems to ignore property rights of the recipients of that protection. It seems, whilst seeking to facilitate fairness in takeovers, the protection of minority shareholders is only incidental to the objective of facilitating corporate restructuring. Thus, the squeeze-out right renders obsolete the property rights of minority shareholders. At the EU level, the Winter Report, having considered the enigma, argued that without a squeeze-out right, takeover bids are less attractive to potential bidders – because of the costs and risks relating to the existence of minority shareholders after the bid. The Winter Report concluded that, so long as the squeeze-out right applies only when the minority is fairly small and appropriate compensation is offered, its use to address public interests, is proportionate.⁹⁴ It is difficult to see how forcing a minority shareholder out of the company against his will thereby creating concentrated share ownership makes takeovers attractive to potential future bidders. At the UK level, the Company Law Review Steering Group saw the minority's plight as follows:

A minority shareholder, without control over the company, and most probably without any ready yardstick against which to measure the value of his shares, the strength of his bargaining position is in any event based solely on *his ability to refuse to sell*. We do not think that it would be possible to devise ... sufficient safeguards to protect a minority shareholder's interests, to justify depriving him of the one card of value he retains in his hand.⁹⁵

Paradoxically, even though the UK's Company Law Review Steering Group recognised the infringement of property rights that a compulsory squeeze-out creates, could only empathise with the plight of minority shareholders. The Winter Report found that various courts in the Member States had ruled that the squeeze-out right was not to be regarded as incompatible with property rights, as the squeeze-out right is not exercised to satisfy private interests only but public interests. Although squeeze-out rights have long been accepted as part of UK and EU company laws, it does not only seem to infringe minority property rights, but also renders minority shareholding an illusory right. But studies show that the notion that shareholders' ownership rights run counter to a squeeze-out is today mostly no longer accepted, instead, the law caters for only the purely financial interest of the minority, whilst averting the danger of hampering the efficiency of the market for corporate control.⁹⁶

It seems, the squeeze-out right of a bidder who has either acquired, or contracted to acquire, 90 per cent or more of the shares carrying voting rights in a

94 See the Winter Report (2002) 61–62.

95 Modern Company Law for a Competitive Economy – Final Report (DTI, 2001) 283 – *emphasis added*.

96 M Siems *Convergence in Shareholder Law* (Cambridge, Cambridge University Press, 2008) 209.

given class of shares,⁹⁷ cannot be defeated on ground that the minority shareholder does not wish to sell his shares. UK courts have, under the old statutory regimes, only looked at applications resisting compulsory purchase if founded on grounds that the offer was unfair; but even then the courts have not favoured such applications.⁹⁸ Moreover, the onus is on the minority shareholder to prove that the offer was unfair.⁹⁹ The test of fairness is not on whether it is fair for a minority's property rights and liberties of investment to be removed, but on whether the price offered to the minority shareholder in return is a commercially acceptable offer price. However, the compulsory purchase is only restricted to takeovers.¹⁰⁰ Thus, fairness in takeovers is all about economics, not law – the law's intervention is only an economical dimension applied to maintain commercial usage.

As a matter of economics, of fairness, the fairness of the price to be paid for compulsory purchase in takeovers is accessed via a mechanism of legal presumptions. The acceptance of the offer price by the majority is evidence that the price was fair. The test is this: 'where the statutory majority have accepted the offer, the onus must rest on an applicant to satisfy the court that the price offered is unfair.'¹⁰¹ The highest price paid to the accepting shareholders is presumed to be a fair price, which is paid for the squeeze-out purchase. Where the pre-bid market price is higher than the offer price, the minority is bound to take the offer price. It is unlikely that the majority would accept an offer less than the pre-bid market price. But even if the majority accepted a lower price, the minority would not be less disadvantaged than the majority, for both receive the same price.

Unlike in other jurisdictions, English law does not require the price paid for squeeze-out to be not lower than the pre-bid market price.¹⁰² The fact that English law on the squeeze-out price is based on the offer price accepted by the majority, rather than the pre-bid price, to some extent, demonstrates the acceptance of the right of the majority to expropriate the minority.

97 Article 15.4 of the Directive.

98 In *Re Bugle Press Ltd* [1961] Ch 270, 276–277 Buckley J said: 'where the 90 per cent majority who accept the offer are unconnected with the persons who are concerned with making the offer, the court pays the greatest attention to the views of that majority. In all commercial matters, where commercial people are much better able to judge of their own affairs than the court is able to do, the court is accustomed to pay the greatest attention to what commercial people who are concerned with the transaction in fact decide.'

99 *Re Gierson, Oldham and Adams Ltd* [1968] Ch 17.

100 *Re Bugle Press Ltd* [1961] Ch 270.

101 *Re Press Caps* [1949] Ch 434 at 446 per Wynn-Parry J.

102 Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 642.

Outside economic analysis of the law, the squeeze-out right is hardly equitable. Take for example, a company that started off as a one-man private company, increased its value over the years and changed to a public company, then listed to trade its shares on a regulated market. A takeover bidder comes along and acquires 90 per cent of the shares. A minority shareholder and founder of the company who wish to retain his investment in the company for his retirement income, pleads to the law for his vested interests. In response, the law is only concerned with whether a fair price has been offered to him. It is an indifferent legal response to minority plight for public commercial interests. If that were the law's response in protecting the private vested interests of this minority shareholder, he would be horrified at the manner of protection accorded to him. In the end, the acceptance of the squeeze-out right in company law is in effect a promotion of public commercial interests at the expense of protecting the private investment interests of minority shareholders who may not wish to give up their vested shareholding.

Moreover, if the shareholder being squeezed out should sacrifice his property interests for the public good to make takeovers attractive to future bidders, it is difficult to see how that rationale is justified. The bidder will in turn hold 100 per cent shares, turning the share structure of the company into a concentrated ownership, which makes it the more difficult for future bidders. In structures with one shareholder holding shares sufficient to carry control of the company, future bidders have to pay him a high premium for a takeover to occur; this is because 'he has something to sell – control – which the others considered separately have not.'¹⁰³ It is argued that, in concentrated share ownership, especially if shares are vested in a single shareholder after a bid, 'an acquisition will only occur when – and only when – the controller consents or has somehow lost control'¹⁰⁴ – hence, favouring a bidder to squeeze-out a minority does not attract future bidders but rather repels them. Most of continental Europe has for a long time had a concentrated share ownership structure, and so no wonder many EU Member States found the squeeze-out right favourable.

Rather than the law's indifferent response to the plight of minority shareholder in whom there is no interest to sell his shares, a principle prohibiting prejudicial conduct by a shareholder, should be developed. Under this suggested principle, the conduct of a shareholder should not prejudice the interests of the company. Under this principle, a squeeze-out right should only be applied if 'the minority shareholder was in some way acting in a manner destructive or highly damaging to the interests of the company from some

103 *Short v Treasury Commissioners* [1948] AC 534 at 546 per Lord Uthwatt.

104 Allen Ferrell, 'Why Continental European Takeover Law Matters' In: Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 561, 562.

motives entirely of his own.’¹⁰⁵ In assessing a shareholder’s conduct, the test should be subjective and regard should only be had to the personal conduct of the shareholder in question. There is nothing in the Takeover Directive that precludes developing a measure applying the squeeze-out right in the manner suggested. The courts of equity would be accustomed with this body of principles. But the current UK practice militates against a minority successfully claiming unfair treatment.¹⁰⁶

Infringement of property rights aside, there is an issue of classes of shares. The Takeover Directive is silent as to the treatment of classes of shares in calculating the threshold for launching a squeeze-out by the offeror. Most Member States (for example, Belgium, France, Germany and The Netherlands) have a general threshold with no division into classes of shares.¹⁰⁷ The UK operates a class-based approach for calculating the threshold for the squeeze-out right of the offeror.¹⁰⁸ The class-based approach is more favourable to minority shareholders, as it offers a protection commensurate with the level of class rights.

For example, where the target has two classes of shares, A and B, with the former accounting for 98 per cent and the latter two per cent, a minority shareholder with 12 per cent of the class B shares can prevent the offeror from fully exercising his squeeze-out right, as the offeror will fail to reach a 90 per cent threshold in class B shares. The difficulty in achieving the squeeze-out right does not deny the minority shareholder the sell-out right, as the minority has the option of tendering his shares during the offer period.

So far on the foregoing, it is clear that minority shareholders are a venerable class of investors who therefore need protection. It is argued here that the change of corporate control power from the offeree shareholders to the offeror is essentially a majority shareholder transaction, as the bid will only be successful if the majority accept. This majority transaction, coupled with the potential control power battle between the offeree board and the offeror, is likely to turn the minority shareholder into a victim. Besides a minority who is reluctant to exit the company, it is to this new circumstance that takeover law intervenes, by way of sell-out rights accorded to the minority shareholders. The sell-out right is the right of the minority shareholder to

105 *Re Bugle Press Ltd* [1960] 3 All ER 791 at 796 per Lord Evershed MR – the ratio in this case was on the determination of improper use of a squeeze-out right and not how the right should be applied, the latter is the argument in this article.

106 *Re Bugle Press Ltd* [1961] Ch 270; *Re Chez Nico (Restaurants) Ltd* [1992] BCLC 192; *Fiske Nominees Ltd v Dwyka Diamond Ltd* [2002] 2 BCLC 123.

107 C Elst and L Steen, “Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-out and Sell-out Rights” (2009) ECFR 391, 415.

108 Section 979 of the Companies Act 2006.

compel the majority shareholder to purchase the shares of the minority shareholder.¹⁰⁹

It should be noted though that, minority shareholders are not protected on every change of control in the company. Changes of control can occur in a number of ways, and other events that trigger a change of control could result in changes of policy, such as a change in the company's business activities, and could also have a detrimental effect on the minority shareholders.¹¹⁰ It does not follow that the law protects minority shareholders each time there is a change of control. In English company law, other than in a takeover situation, the law does not offer the same protection to minority shareholders.¹¹¹ In takeovers, the real goal of the mandatory bid is not so much the one of protecting minority investors from any change in control, but rather from a change in control when the resulting ownership structure of the corporation is characterised by the presence of a large block-holder.¹¹² As such, the Takeover Directive adds little, for it protects at change of control, giving the minority a sell-out exit strategy, which leaves a need for a more comprehensive minority protection regime.

Even in takeover situation, the sell-out right is not all roses for minority shareholders. First, the offeror may fail to reach the 90 per cent threshold that triggers a sell-out right for the minority, leaving the minority who wish to exit the company locked therein. Second, where the threshold is reached, the time limit set for the minority shareholder to exercise a sell-out right, being 'any time before the end of the period within which the offer can be accepted,'¹¹³ may be somewhat short. Where the sell-out right is triggered shortly before the close of the bid, the minority shareholder will have a short time to consider the fairness of tendering.

If there be any consolation for a minority shareholder wishing to exercise a sell-out right, but for the limitation on the window of time in which to do so, the UK position in calculating the threshold favours the offeree than the offeror. Whereas treasury shares are excluded in calculating the threshold for a squeeze-out right,¹¹⁴ treasury shares are included in calculating the

109 Article 16 of the Takeover Directive.

110 J Payne, "Minority shareholder protection in takeovers: A UK perspective" (2011) ECFR 145, 151.

111 See *Re Astec (BSR) plc* [1998] 2 BCLC 556.

112 Marco Ventoruzzo, "Takeover Regulation as a Wolf in Sheep's Clothing: Taking UK rules to Continental Europe" (2008) University of Pennsylvania Journal of Business Law 135, 140.

113 Section 984(2) of the Companies Act 2006.

114 Section 974 of the Companies Act 2006.

threshold for a sell-out right.¹¹⁵ This gives a higher protection to the minority shareholder to exercise a sell-out right than it does for the majority bidder to exercise a squeeze-out right.

Further, the calculation for squeeze-out excludes the bidder's shares held at the start of the offer, but these are included in the threshold for a sell-out right.¹¹⁶ As such, the threshold to exercise a sell-out right is easily reached to allow an exercise thereof to facilitate an exit.

VI. *Compulsory acquisition clauses in articles of association*

Besides takeover regulations, there is an equivalent to squeeze-out right that can be provided for in the articles of association. In the UK, way before the squeeze-out regime in takeovers was in place, there were cases at common law where it was equitable to compulsorily acquire the shares of a minority shareholder. At common law, compulsory acquisition was largely dependant on the power provided in the articles of association. It was established at common law that compulsory acquisition clauses in articles of association are valid and enforceable.¹¹⁷ The question then is where they exist, whether these compulsory acquisition clauses in articles of association could in effect achieve the same purpose as that of the squeeze-out right in takeover law.

Majority of the compulsory acquisition clauses have a lower threshold, usually 75 per cent, than the threshold in takeover law at 90 per cent. These have advantages for both the majority and the minority shareholders. For the majority, these compulsory acquisition clauses attract bidders who would otherwise find a higher threshold difficult to achieve, whilst for the minority shareholders, they can simply benefit from the premium share price secured by the majority acceptance of the offer.

Compulsory acquisition clauses can be provided in the articles of association from the outset. Where that is the case, the clauses are enforceable as a matter of a statutory contract.¹¹⁸ In *Phillips v Manufacturers' Securities Ltd*, where the articles of association provided for a compulsory purchase of members' shares on passing a resolution to that effect, the Court of Appeal rejected an application by a shareholder for an injunction to restrain the company from en-

115 Section 983(5) of the Companies Act 2006.

116 See *Palmer's Company Law Annotated Guide to the Companies Act 2006* (London: Sweet and Maxwell, 2007) 724.

117 *Phillips v Manufacturers' Securities Ltd* (1917) 86 LJ Ch 305, 116 LT 290.

118 Section 33 of the Companies Act 2006; *Hickman v Kent or Romney March Sheep-breeders' Association* [1915] 1 Ch 881; *Rayfield v Hands* [1960] Ch 1; *Wood v Odessa Waterworks Co* (1889) 42 Ch D 636.

forcing the articles against him. If the provision is already in the articles, then we can assume the minority shareholders undertook to be bound by it when they bought shares into the company.

It is also permissible to alter the articles afterwards to provide for a compulsory purchase provision. In *Sidebottom v Kershaw Leese & Co Ltd*, it was observed that such a provision could be added on the alteration of the articles.¹¹⁹ If this right has to be inserted on alteration of articles, the law provides an array of rules aimed at protecting the minority shareholders. These include the rule to alter the articles ‘bona fide for the benefit of the company as a whole,’¹²⁰ a higher threshold to alter articles affecting class rights,¹²¹ rules on weighted votes when passing alteration resolution,¹²² and non binding effect of alteration that increases a member’s liability to contribute to the company’s share capital without that member’s agreement.¹²³ In Germany, there are similar provisions permitting alteration of articles, but not explicit for the aktien-gesellschaften, as section 23(5) AktG permits articles to be altered only to the extent specifically permitted by the AktG – for example, section 203 AktG permits for the authorisation in the articles to issue new shares to be substituted for the resolution on the share capital increase.

In English law, the protection accorded to minority shareholders is reflected in the emphasis on requiring the alternation to be for the benefit of the company as an entity. In *Brown v British Abrasive Wheel Co Ltd*,¹²⁴ the court refused to allow a compulsory purchase that subjectively benefited the majority rather than the company as an entity. In *Dafen Tinplate Co Ltd v Llanelly Steel Co Ltd*,¹²⁵ the court refused to allow an alteration of the articles that would enable the majority to compulsorily purchase shares of any other member. In *Dafen Tinplate Co Ltd*, the court found that the majority were confusing their own interests with the benefit of the company as a whole.¹²⁶ In *Sidebottom v Kershaw Leese & Co Ltd*,¹²⁷ the court allowed an alteration of the articles to include a provision for the majority to compulsorily purchase the minority shares, having found that the alteration was bona fide for the benefit of the company as a whole.

119 [1920] 1 Ch 154 at 162 and 170 per Lord Sterndale MR and Warrington LJ.

120 *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656 at 671 per Lindley MR.

121 Section 630 CA 2006; *Cumbrian Newspapers Ltd v Cumberland & Westmoreland Printing Ltd* [1987] Ch 1.

122 *Bushell v Faith* [1970] AC 1099.

123 Section 25 CA 2006.

124 [1919] 1 Ch 290.

125 [1920] 2 Ch 124.

126 [1920] 2 Ch 124 at 141 per Peterson J.

127 [1920] 1 Ch 154.

The application of these English cases compared with the provisions in Takeover Directive at EU level (implemented by Part 28 of the Companies Act 2006) seem contradictory, as the latter seem to allow expropriation of minority shareholders without the requirement of bona fides required in the former. A closer examination of these cases indicates that the cases are concerned with matters of internal management of the company by way of rules governing the 'horizontal' ongoing relationship between shareholders inter se via alteration of articles, whilst Part 28 of the Companies Act 2006 is concerned with external management of the company by way of rules governing restructuring the status of shareholders via takeovers.

This calls for an answer to the question whether a compulsory purchase clause in the articles achieves the same results as a squeeze-out right in takeover law. It should be noted that there are no overlaps between the right to compulsorily purchase a member's shares via a power to alter the articles under section 22 and via the squeeze-out under section 984 of the Companies Act 2006 (Article 15 of the Takeover Directive), as the two serve different objectives. The cases examined show a restriction on the former, as the power to alter the articles is primarily to govern the relationship between shareholders inter se and not to terminate their status per se. The latter serves an economic benefit and a public interest in restructuring of companies. Moreover, takeover mechanism contains a range of protections for shareholders that are not present in alteration of articles. To allow restructuring to be achieved via an alteration of the articles would circumvent the protections for shareholders contained in those mechanisms.¹²⁸

In takeovers, it is common for the bidder to wish to acquire all of the shares of the target company so as to have complete freedom in running the acquired business without the need to negotiate with minority shareholders.¹²⁹ Thus the rules, ensuring a fair price is paid to the minority shareholder, provides for a squeeze-out right. But whether this is achieved via the alteration of articles to provide a compulsory purchase right or via takeover mechanism the effect is the same to a minority shareholder who is reluctant to take an exit route. The harsh effect of either is that compulsory purchase of shares seems to be contrary to contractual relationship created by the nature of shares.¹³⁰ Compulsory purchase goes against the argument that the permanency of investment is a hallmark of the corporate form.¹³¹ In all this, 'the issue is whether the ma-

128 B Hannigan, 'Altering the articles to allow for compulsory transfer – dragging minority shareholders to a reluctant exit' (2007) JBL 471, 498.

129 B Hannigan, 'Altering the articles to allow for compulsory transfer – dragging minority shareholders to a reluctant exit' (2007) JBL 471, 473.

130 See *O'Neill v Phillips* [1999] 2 BCLC 1 at 14.

131 Kraakman et al, *The Anatomy of Corporate Law* (2004) 139–144, 60; *Re Bird Precision Bellows Ltd* [1984] 3 All ER 444 at 449–450 (affirmed [1985] 3 All ER 523).

majority shareholders can bring to an end the minority's very status as a shareholder.¹³² The law here could be seen as undermining the permanence of investment, rendering it a temporary investment that can be set aside by the majority at will.

It is argued that the rules in takeovers are not per se on the nature of shareholding but rather on facilitating restructuring of companies and ensuring fairness in so doing. The legislators having predetermined the first limb of *Allen*, for a proper purpose, the question then is whether the compulsory purchase is on a fair price. Moreover, in general law, a fair price could take into account the proportion minority shares bear on control, for 'it is not unfair to offer a minority shareholder the value of what he possesses, i.e., a minority shareholding.'¹³³ Hence, in takeovers, a fair price calculated on the basis of the highest price paid in the last 12 months,¹³⁴ without discounting minority shares, could be generously fair. As to ownership rights, the interests of minority shareholders in remaining in the company is overridden by public interest that lies in corporate restructuring for a wider economic purpose.

Further, even outside takeovers, a compulsory purchase via alteration of articles can be aligned with the wider economic purpose of corporate restructuring, provided a fair price is paid. Alteration of articles that seeks to expropriate other shareholders, according to the Australian case, *Gambotto v WCP Ltd*,¹³⁵ would only be justified if it was done for a proper purpose and not oppressive. The Australian court in *Gambotto* attached much weight to the proprietary nature of a share – that is, shares are more than a capitalised income stream. But English courts have not adopted this approach and seem to accept that shares can be expropriated as long as a fair value is paid.¹³⁶ A similar approach taken in Germany accepts that shares can be expropriated as long as adequate compensation is paid, as is regarded by the German Federal Constitutional Court.¹³⁷ 'An alternative perception of the share is to see it as a "capitalised dividend stream" which entails that, provided the compensation paid to the shareholder being expropriated results in no diminution in his investment return as compared with holding on to the share, there has simply been no prejudice.'¹³⁸

132 B Hannigan, 'Altering the articles to allow for compulsory transfer – dragging minority shareholders to a reluctant exit' (2007) JBL 471, 491.

133 *Re Grierson, Oldham & Adams Ltd* [1968] Ch 17 at 35 per Plowman J.

134 Article 5 of the Takeover Directive.

135 (1995) 182 CLR 432.

136 See judgment of Lord Hoffmann in *O'Neill v Phillips* [1999] 1 WLR 1092.

137 See the judgment BVerfGE 27. 4. 1999 – 1 BvR 1613/94, E 100, 289 and the preceding judgment 7. 8. 1962 – 1 BvL 16/60, E 14, 263.

138 DD Prentice, 'Alteration of articles of association – expropriation of shares' (1996) LQR 194, 197.

VII. Conclusion

This article has argued that the UK takeover system offers a better protection to minority shareholders than accorded at EU level. This is especially seen in the board neutrality rule and the equal treatment principle. At EU level, it noted that a major task in the Takeover Directive is to strike a balance between on the one hand the objective of facilitating corporate restructuring through takeover activities, and on the other hand the need for protecting the interests of minority shareholders, with the latter being incidental to the former.

This article argued that the protection of minority shareholders, at EU level, is only a method aimed at creating an internal market as an area without internal frontiers in which freedom of establishment of companies and free movement of capital is ensured. To this end, takeover law, which treats unfair treatment of minority shareholders as a barrier to restructuring of companies, seeks to ensure that investors are free to put their money into shares of EU companies in order to establish themselves in another Member State and to provide necessary capital for the development and expansion of those companies. To achieve this, takeover rules provides for a mechanisms such as equal treatment, mandatory bid, and squeeze-out.

This article noted that much as the mandatory bid rule is meant to prevent arbitrary control if bidders would freely buy shares, the rule is arguably capable of escalating arbitrary control in cases where the offeror intended only to raise his portfolio to slightly over the threshold. The other negative effect of a mandatory bid is the destabilising of minority investment portfolios, where a squeeze-out right is subsequently triggered. The article noted however, it is difficult to see a better way than by a mandatory rule, for if it is left to the market forces of demand and supply, minority shareholders may not have even the remedy of selling their shares at a fair price. The law's protection of the minority is to provide an exit strategy at a fair price.

On the particular exercise of the squeeze-out right, the article noted that the right accords with the argument that takeover regulation is not about protection of minority shareholders *per se*, but about facilitating the objective of corporate restructuring, with the former only a method of achieving the latter. It noted that squeeze-out rights goes against the permanence of share holding, and trumps minority shareholders' property rights. It noted that, both at UK and EU levels, in takeovers, the interest of minority shareholders in remaining in the company is overridden by public interest that lies in corporate restructuring for a wider economic purpose. The ultimate protection for minority shareholders is the law's response of ensuring that a fair price is paid to the shareholder. This article concludes that, minority protection in takeovers is about market fairness and not about property or legal rights *per se*.

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